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Utility Regulator
Queen's house
14 Queen Street
Belfast
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16th November 2012

RE: Treatment of Gas Transportation Capacity Costs Consultation (SEM-12-089)

Dear Kenny,

Bord Gáis Energy (**BG Energy**) welcomes the opportunity to respond to the Consultation on the treatment of gas transportation capacity costs in the SEM (**the Consultation**).

BG Energy believes that under the terms of SEM generators' licences, Gas Capacity should be considered a Short Run Marginal Cost (**SRMC**) in both Northern Ireland (**NI**) and the Republic of Ireland (**ROI**). All SEM generators can access short-term gas transportation capacity (**Gas Capacity**) in NI and ROI placing them on a level playing field with each other. The Bidding Code of Practice is a theoretical construct and does not allow for choice, flexibility or subjectivity in its interpretation. An objective reading of the BCOP determines that there is a transparent price source that can be referenced by all SEM generators for inclusion as a SRMC in their Commercial Offer Data. There are no reasonable grounds to differentiate between generators in NI and ROI when it comes to bidding in the SRMC of Gas Capacity.

The remainder of this response expands on the reasoning for BG Energy's position, which is predicated on the explicit terms of SEM generators' licences and the wording of the Bidding Code of Practice.

1. The "Cost-Reflective" Requirement of Commercial Offer Data

Under SEM generators' licences¹ (**the Licence**), the value of all price components of submitted Commercial Offer Data must be "cost-reflective". Under the Licence a price component is considered to be "cost-reflective" only if the implied cost of Output incurred by a Generator Unit² "*in respect of the Trading Day to which the Commercial Offer Data submitted... is equal to the Short Run Marginal Cost related to that generation unit in respect of that Trading Day.*"³

The Licence thus explicitly states that as long as a price component *relates* to a Trading Day, then it can be included in Commercial Offer Data based on its Short Run Marginal Cost. At no

¹ AIP-SEM-07-333 (the Generic Licence), "Cost-Reflective Bidding in the Single Electricity Market".

² Wording taken from the definition of "Schedule Production Cost" in the Trading and Settlement Code (Glossary). The Schedule Production Cost is referenced in Condition 15(2) of the Generic Licence AIP-SEM-07-333 which explains what "cost-reflective" means.

³ Condition 15(2).

point does the Licence or any related document state that the cost of the price component must be incurred on a day-ahead basis. A price component must simply be capable of being bought with a view to being used on a particular trading day. In reality the cost of price-components for a particular Trading Day can be incurred up to almost a month ahead of the Trading Day, which is evidenced by the fact that the Trading and Settlement Code permits Commercial Offer Data to be submitted for a particular Trading Day from 29 days ahead to one day ahead of a Trading Day.⁴

The RAs' decision to exclude NI generators from the obligation to bid in SRMC of Gas Capacity on the basis that they can only book capacity 12 days in advance of the Trading Day (as opposed to one day in advance in ROI), is therefore unfounded. BG Energy reiterates that short term Gas Capacity can be purchased with a view to its use on a particular Trading Day in NI and ROI. It is thus a SRMC under the Licence and must therefore be included in generators' Commercial Offer Data in NI and ROI and all SEM generators should be treated equally.

2. Calculation of the SRMC to include in Commercial Offer Data

a. The Theory

On the establishment of SEM, the RAs determined that the framework according to which SEM generators would be bound to comply with when bidding in Commercial Offer Data, would comprise of the Licence and the Bidding Code of Practice (**BCOP**).

Importantly, there is no scope for subjective interpretation of the BCOP and commercial realities or speculations around different plant types are not permitted to be taken into consideration. Its role is to ascertain a source of transparently costing price-components of Commercial Offer Data to ensure a level playing field for all SEM generators. An ordinary meaning must be applied to the BCOP where its terms are clear and explicit. One of these terms is the definition of "Opportunity Cost". Significantly on the adoption of the BCOP in 2007, the RAs explicitly stated that "Opportunity Cost" was the "correct conceptual construct"⁵ to use when determining the appropriate SRMC of a cost-item to include in Commercial Offer Data. The BCOP thus explicitly provides that ascertaining the Opportunity Cost is a theoretical exercise. It must accordingly be interpreted objectively in that ordinary meaning must be applied to it when an ordinary understanding is clearly derivable from the words used.

Having established above in section 1 that daily Gas Capacity is a SRMC in NI and ROI, the question now is what the value of the SRMC of Gas Capacity to include in Commercial Offer Data is. The answer to this lies in a plain reading and objective application of the Licence and the BCOP. The Licence specifies that the SRMC of a price component for a generation unit is equal to the "Opportunity Cost" of it operating to generate electricity on a Trading Day minus the Opportunity Cost of not so operating.⁶

⁴ The Gate Window Opening of EA1, from which time Commercial Offer Data in relation to a particular Trading Day can be submitted, is "10:00 on the day that is 29 days prior to the start of the Trading Day". Trading and Settlement Code, Version 11.0, Section 4.3A, emphasis added.

⁵ AIP-SEM-07-430, page 4, 'The Bidding Code of Practice: A Response and Decision Paper'.

⁶ AIP-SEM-07-333, the Generic Licence, Condition 15 'Cost-Reflective Bidding in the Single Electricity Market', Condition 15(3) and (4).

A large section of the BCOP is dedicated to defining what the Opportunity Cost of a price component of Commercial Offer Data should be. In essence, the BCOP provides that the Opportunity Cost of any cost-item comprises the value of the “benefit foregone” in using that item for electricity generation by reference to its “most valuable realisable alternative use” other than for electricity generation.⁷ To calculate the “benefit foregone” depends simply on whether there is a recognised and generally accessible trading market in the relevant cost item (BCOP Condition 8):

- (i) If there is, the Opportunity Cost is the cost the generator would incur in offering that cost-item for sale or acquiring it, on such a recognised and generally accessible trading market;
- (ii) If there is not, the Opportunity Cost is the cost incurred by the generator in replacing that cost-item.⁸

b. The Application of the Theory

The benefit foregone thus depends on whether or not there exists a “recognised and generally accessible trading market in the relevant cost-item”. In ROI’s Gas Capacity market, there are two opportunities to purchase gas, either the regulated gas capacity at the regulated price or on the “resale market” for which there is a clear floor price only. In NI’s Gas Capacity market there is similar to ROI, a published transparent reference price for regulated gas capacity but no opportunity to purchase resale gas.

BG Energy therefore believes that there is arguably only a “resale market” for Gas Capacity in ROI. However there is significant uncertainty surrounding the price of these capacity sales in ROI and the future existence of the ‘market’ from October 2013 onwards. On this basis, the “resale market” is most likely an inappropriate reference point for providing transparency and a level playing field for SEM generators as required pursuant to the BCOP. BCOP Condition 8(ii) must therefore apply. The Opportunity Cost is therefore the cost incurred by the generator in replacing the cost-item (Gas Capacity).

Given the intended theoretical nature of Opportunity Cost, an objective price source to use as the cost incurred in replacing Gas Capacity must be ascertained. As there are regulated short term Gas Capacity prices published in both NI and ROI (Bord Gáis Networks and Gaslink published tariffs and related daily multipliers per month), BG Energy submits that these prices are a fair, transparent source of pricing for SEM generators to use when costing the SRMC of the Gas Capacity price components and can be easily monitored.

c. Conclusion

On the basis of the above, BG Energy asserts that as explicitly intended by the RAs on its adoption, the BCOP is a theoretical construct as is the concept of “Opportunity Cost”. An objective reading or interpretation of Opportunity Cost is therefore required.

For this reason, BG Energy believes that it is inappropriate for the RAs to put forward its subjective and speculative views as to what commercial decisions generators in the SEM might make with regard to Gas Capacity purchases (for example the RAs’ discussion in the

⁷ BCOP Condition 7.

⁸ BCOP Condition 8(i) and (ii).

Consultation of whether it is more economic for certain plant types to purchase short-term capacity as and when it is needed versus purchasing capacity on an annual or monthly basis).⁹ Such commercially-influenced subjective comments must be disregarded as they are beyond the scope for interpretation of the BCOP permitted to the RAs.

BG Energy therefore concludes that there can be no commercial speculation or subjective interpretation applied when applying BCOP or any of its terms. An objective view is required to theoretically determine the Opportunity Cost of Gas Capacity. An equivalent approach must be applied in NI and ROI and as a “resale market” arguably only exists in ROI, the fairest most transparent data source to use is the regulated price of Gas Capacity published in NI and ROI from which SEM generators can easily garner a daily Gas Capacity price to use in Commercial Offer Data. Use of this source will also facilitate MMU monitoring.

3. Inclusion of Gas Capacity costs in the Capacity Payment Mechanism

Finally the RAs express the concern that if Gas Capacity is included in Commercial Offer Data then generators may be double-remunerated given that the calculation of the Best New Entrant (BNE) peaker’s fixed costs for the Capacity Payment Mechanism (CPM) considers Gas Capacity costs.

BG Energy does not consider this to be a major issue or that the 2013 BNE decision would need to be re-opened if the decision is made to allow Gas Capacity to be included in Commercial Offer Data. The reason for this is that, while Gas Capacity costs were considered in the BNE calculations, the fact is the BNE technology choice since SEM’s inception has been a distillate plant. SEM generators have not been, nor will they be, recovering any part of the costs of Gas Capacity through the CPM until at least 2016 and this would require a change in the chosen technology for the BNE.¹⁰

While there is potential for SEM generators to be double-paid for Gas Capacity if the BNE technology is a dual-fuelled generator in future,¹¹ BG Energy understands that if Gas Capacity costs had been excluded from the BNE fixed costs calculations for 2013, the chosen BNE technology would still be the distillate plant. If the decision is made to allow inclusion of Gas Capacity in Commercial Offer Data going forward, there is therefore no need to re-open the 2013 BNE peaker decision. However, BG Energy believes that if the decision is made to allow the inclusion of Gas Capacity costs in Commercial Offer Data, it would be appropriate to exclude them from the Recurring Costs section in *future* BNE calculations, as they would cease to be fixed costs.

4. Summary and Conclusions

In summary, BG Energy believes that NI and ROI generators must be treated equally and bid in the cost of the Gas Capacity in their Commercial Offer Data for the following reasons:

- i. As long as the SRMC of a price component of Commercial Offer Data relates to a particular Trading Day, then it can be included in generators’ Commercial Offer Data. A

⁹ Pages 8-10 of the Consultation.

¹⁰ As the BNE is fixed for three years from 2013.

¹¹ As the choice of such a technology would mean that its fixed costs and thus the value of the CPM revenue stream would be taking account of Gas Capacity costs.

Short Run Marginal Cost does not need to be incurred on a day-ahead basis, a point reinforced by the fact that the Trading and Settlement Code permits such Data to be submitted from 29 days ahead to the day-ahead of a Trading Day;

- ii. The Bidding Code of Practice is not an interpretative document with choice or flexibility for interpretation. It is a theoretical construct and the Opportunity Cost of a price component must be judged conceptually. Where there is no “recognised and generally accessible trading market” in a cost-item, its Opportunity Cost is the cost of replacing that cost-item. On an objective basis, the only transparent price that can be referenced both in NI and ROI for a cost-item that exists in both NI and ROI, is the regulated price of Gas Capacity (Bord Gáis Network and Gaslink published tariffs and related daily multipliers). There is no reason not to treat NI and ROI generators on a level playing field in terms of data source to use for Gas Capacity costs.

Finally, BG Energy does not believe that if the decision is made to allow Gas Capacity short term costs to be included in Commercial Offer Data that the Capacity Payments Mechanism Decision 2013 needs to be re-opened as the chosen plant for the time is the distillate plant. Any future such decisions should however exclude Gas Capacity from the fixed costs of a BNE peaker if generators can submit Gas Capacity costs with their Commercial Offer Data.

I hope that you provide the above comments and suggestions helpful. If you wish to discuss any of the issues further, please do not hesitate to contact me.

Yours sincerely,

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Bord Gáis Energy

{By email}